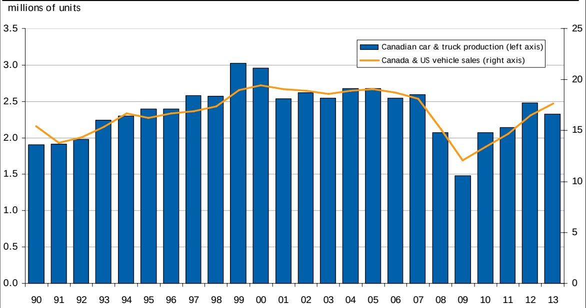
CURRENT ANALYSIS

May 2014

A Look at the Recovery of the Canadian Auto Sector since the 2008-09 Recession

- Auto industry shipments still remain 15% below pre-recession levels.
- The recovery in auto industry shipments continues to lag other manufacturing sectors in Canada.
- Employment growth has underperformed given the rebound in production; less than 20% of auto industry jobs lost during the recession have been recovered.
- Capital spending in Canada's auto industry remains low and investment intentions point to only modest growth in 2014.
- Looking ahead, a positive sales outlook in Canada and the US along with recent depreciation of the Canadian dollar should result in further motor vehicle production growth, though greater benefits are expected to accrue to facilities in Mexico and the Southern US.

Chart 1: Motor vehicle production and Canada & US auto sales



Source: Statistics Canada, Bureau of Economics Analysis, Automotive News, RBC Economics Research

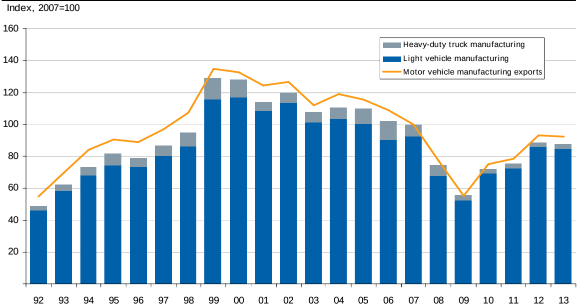
Introduction

This paper analyzes the degree to which the auto industry has recovered in Canada since the last recession. The analysis shows that while Canada's motor vehicle and parts industries have rebounded following the recession, structural changes have limited a return to pre-recession levels of activity. Looking ahead, these structural changes will limit the extent to which Canadian auto manufacturing benefits from the expected further recovery in North American auto sales.

Shipments and unit production

Canada's manufacturing industries were hit hard during the recession, with nominal factory sales falling by 18% between 2007 and 2009. The auto industry saw a particularly significant decline, with factory sales in motor vehicle and parts manufacturing industries (which consists of three components: motor vehicle manufacturing; body and trailer manufacturing; and parts manufacturing industries) plunging 43%, mirroring the decline in car and truck production from 2.6 million units in 2007 to 1.5 million in 2009 (Chart 1). While overall manufacturing sales have nearly recovered to their pre-recession level, automotive industry shipments in 2013 were still 15% less than in 2007. No progress was made in this recovery in 2013 as motor vehicle industry shipments fell for the first time since the recession and car and truck production edged down to 2.3 million units from 2.5 million in 2012.

Chart 2: Motor vehicle manufacturing



Source: Statistics Canada, RBC Economics Research

Of the Canadian auto sector's three main components, motor vehicle manufacturing (consisting of light vehicle and heavy-duty truck manufacturing) has seen the greatest recovery, although activity has yet to return to pre-recession levels. A modest rebound in light vehicle manufacturing has been partially offset by continued declines in heavy-duty truck shipments, leaving total motor vehicle manufacturing sales 13% below their 2007 level (Chart 2). Similarly, Canadian car and truck production of 2.3 million units in 2013 is still short of the 2.6 million units produced in 2007. This is somewhat disappointing given the strong recovery in Canadian motor vehicle sales,

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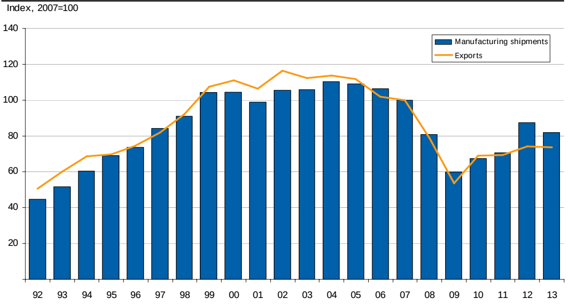
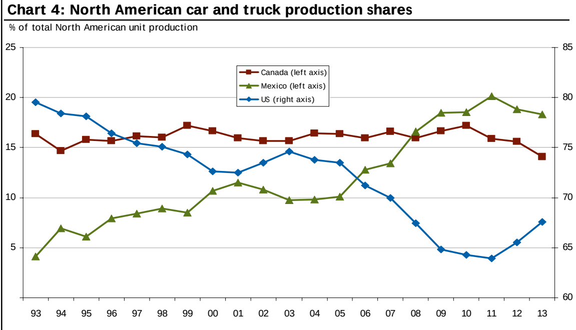
Chart 3: Motor vehicle parts manufacturing



Source: Statistics Canada, Industry Canada, RBC Economics Research

Chart 4: North American car and truck production shares



Source: Automotive News, RBC Economics Research

which hit a record 1.8 million units in 2013, and solid growth in US sales, which totalled 15.9 million units in 2013. The latter has provided a boost to Canadian motor vehicle manufacturers' exports (98% of which go to the US) though they remain some 8% below their 2007 level. Some of the continued underperformance in exports can be attributed to a loss of market share; just over 25% of US car and truck imports came from Canada in 2013, the lowest share on record and well below shares of over 30% prior to the recession. This is largely a reflection of Mexican-made vehicles' growing presence in the US market, which rose to a record-high 23% of US car and truck imports in 2013. This loss of market share may also have reflected the earlier strength in the Canadian dollar.

Compared with motor vehicle manufacturing, recovery in the Canadian auto parts industry (the second main component of the overall auto sector) has lagged somewhat, with shipments remaining 18% below their 2007 level following a dismal 2013 in which sales fell 6.4% (Chart 3). The slow recovery has been a function of both continued weakness in Canadian motor vehicle production and a limited rebound in parts exports, which as of 2013 were 26% lower than in 2007. Exports by motor vehicle parts manufacturers have grown slowly since the recession despite the recovery in US motor vehicle manufacturing where car and truck production returned to pre-recession output levels with 11.1 million units produced in 2013 (compared with 10.9 million units in 2007). The underperformance of exports reflects a dwindling share of the US market as Canadian shipments accounted for just 12.6% of US motor vehicle parts imports in 2013, down from over 20% prior to the recession. As with motor vehicle manufacturing, much of this share has been lost to Mexican parts producers, who have seen their share of US imports rise to 34% in 2013 from around 28% prior to the recession. The weak recovery in Canadian parts exports is partially due to increased vehicle assembly in Mexico and the Southern US, jurisdictions to which shipping parts from Canada can be less cost-competitive. The earlier appreciation of the Canadian dollar may also have weighed on exports.

Similarly, exports of motor vehicle body and trailer manufacturers, the third and smallest component of the overall auto sector, were still 25% below their pre-recession peak in 2013. As a result, body and trailer manufacturing sales have seen the weakest recovery among the three auto sub-industries with shipments in 2013 still 23% lower than in 2007.

The data noted above point to some disappointing trends. Canadian motor vehicle manufacturing has made a modest recovery in recent years but output has not returned to pre-recession levels despite record domestic vehicle sales and strong US auto sales. Exports have fared slightly better, reflecting the solid rebound in US motor vehicle sales, but Canadian manufacturers have lost some of their share of the US car and truck import market. The weak overall recovery in Canadian motor vehicle assembly reflects a shifting North American production landscape, likely aggravated by the earlier strength in the Canadian dollar. Mexico's share of North American production has increased fairly consistently throughout the NAFTA era, peaking at 20% in 2011 from just 7% in 1994 (Chart 4). Most of this share gain first came at the expense of US producers with Canada's share holding steady at around 16-17%. Recently, however, the US' share of motor vehicle output has begun to rebound while Canadian producers have seen their share fall to a record low of 14% of North American output in 2013. Planned capacity expansion in Mexico, including several new plants in the next few years, as well as stronger investment in the US, could result in further erosion of Canadian producers' market share. This would limit the extent to which Canadian manufacturers are able to take advantage of strong auto sales, which we forecast will continue to increase in both Canada and the US over the next few years. The same is true for Canadian parts manufacturers, who have lost a significant share of the US import market. With North American production growth gravitating toward Mexico and the Southern US, this segment of the Canadian auto industry may only see limited growth despite strong North American sales.

Takeaway: Motor vehicle industry shipments in Canada have yet to fully recover following a significant decline during the recession. The positive sales outlook points to further gains; however, declining production share highlights downside risks to Canadian manufacturers taking advantage of strong North American sales growth. Some offset is expected due to recent weakening in the Canadian dollar.

Employment

As with total manufacturing employment, auto industry employment has been very slow to recover since the recession. Motor vehicle, body and trailer, and parts manufacturing industries lost 43.4 thousand jobs between 2007 and 2009 and have added just 8.3 thousand since (Chart 5). The most significant losses were in the parts manufacturing sector, which lost 26.1 thousand jobs and has only added 3.8 thousand since, leaving employment more than 25% below its pre-recession level. Motor vehicle manufacturing also sustained significant job losses; of the 11.9 thousand jobs lost during the recession, only 3.3 thousand have been added since, leaving employment 18% below its pre-recession level. Body and trailer manufacturing similarly lost 5.5 thousand jobs during the recession and has recovered just 1.2 thousand since.

The slower recovery in employment relative to shipments (in motor vehicle manufacturing and parts industries) implies this increased demand is being met by either an increase in average hours worked or higher productivity (or a combination of the two). The former is suggested by anecdotal evidence that employers have elected to maintain flexibility by increasing hours worked rather than bringing on new personnel, doing so either through increased use of overtime or reducing the standard two-week summer shutdown for retooling. However, this conclusion is not backed up by official statistics.[1]

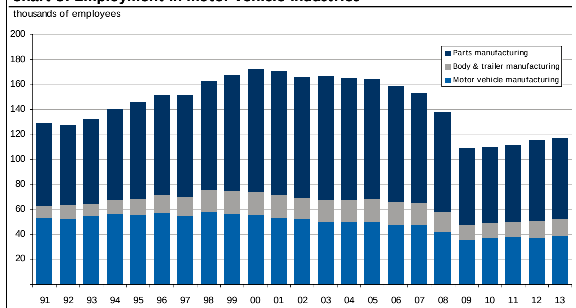
Takeaway: The recovery in employment has lagged that of shipments, implying the possibility of a strong bounce in productivity. An alternative or complementary explanation is that workers are putting in longer hours.

Capacity utilization

While motor vehicle shipments remain below their pre-recession levels, there are indications that capacity utilization in the auto industry has made a strong recovery. Statistics Canada's capacity utilization rates are only available for the broader transportation equipment manufacturing industry; however, the fact that motor vehicle, body and trailer, and parts manufacturing industries make up nearly 80% of shipments in this industry provides some indication. Capacity utilization in transportation equipment manufacturing climbed to a historical-high of 90.8% in 2012 after bottoming out at 66.7% in 2009 (Chart 6). There was a disappointing retracement to 87.0% in 2013 which was largely due to lower overall output in the year, though this may have also reflected increased capacity being brought on stream such as the introduction of a third shift in some plants.

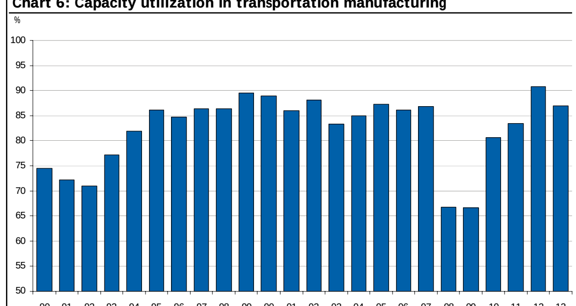
Takeaway: Capacity utilization has rebounded strongly from recessionary lows.

Chart 5: Employment in motor vehicle industries



Source: Statistics Canada, RBC Economics Research

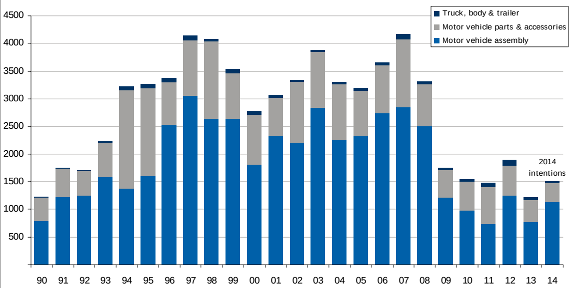
Chart 6: Capacity utilization in transportation manufacturing



Source: Statistics Canada, RBC Economics Research

Chart 7: Auto industry investment

new expenditure on M&E and construction, mil.C$



Source: DesRosiers Automotive, Statistics Canada, RBC Economics Research

Investment

Capital investment in the auto industry fell significantly during the recession and has yet to recover. Investment in motor vehicle and parts manufacturing industries in 2013 was less than a third of what it was in 2007 (Chart 7). According to a survey of investment intentions, auto industry investment should pick up in 2014 as planned capital spending growth of 47% in motor vehicle assembly will more than offset a further decline (-14%) in the parts and accessories sector and a 29% drop in truck body and trailer manufacturing.[2] Nonetheless, this would still leave new capital spending in the auto industry at less than half of the annual investment seen in the years leading up to the recession. Weak investment in the Canadian auto industry is again a reflection of the shift in North American production as most new capital spending is being directed to Mexico and, to a lesser extent, the Southern US. With lower labour costs and better access to Latin American markets, Mexico has attracted significant investment in recent years and will continue to see growth with several new assembly plants set to open in the next few years. Government incentives have also played a role in the allocation of new investment as many auto-producing jurisdictions offer financial assistance to attract new production facilities. This has undoubtedly been a factor in the flow of investment spending to Mexico as well as the Southern US.

Takeaway: Auto industry investment in Canada has been flat in the last several years following a significant decline during the recession with no bounceback over the recovery/expansion. Investment intentions for 2014 show this underperformance continuing as manufacturers direct capital spending to Mexico and the Southern US.

Conclusion

Canada's auto industry continues to recover following a significant hit during the recession, though in most cases activity has failed to return to pre-recession levels. Shipments and unit vehicle production have rebounded fairly well and a positive sales outlook in Canada and the US along with the recent depreciation of the Canadian dollar points to a further recovery; however, the auto sector's gravitational shift toward Mexico and the Southern US will likely set limits to future gains in Canada. Despite the recovery in motor vehicle production following the recession, the rebound in employment has been dismal; just 8.3 of the 43.4 thousand jobs lost between 2007 and 2009 have been recovered since. Slower employment growth implies strong productivity gains; however, data quality issues make definitive conclusions difficult. Nonetheless, the underperformance of job growth is likely a result of manufacturers' shift to a leaner, more flexible production strategy. Such is reflected in the rebound in capacity utilization rates in the auto industry since the depths of the recession, as manufacturers ramp up production without expanding physical production capacity. Capital expenditure in Canada's motor vehicle industries has seen almost no recovery after plummeting during the recession, and while investment intentions point to modest growth in 2014, spending is expected to remain at less than half of pre-recession levels. In the coming years, Canadian manufacturers should be able to meet some of the growing motor vehicle demand with existing capacity. But if capital spending remains at recent lows, Canada's auto industry will likely continue to cede production share to Mexico and the southern US.

[1] Statistics Canada's Survey of Employment, Payrolls and Hours (SEPH) shows average weekly hours in motor vehicle manufacturing have fallen relative to 2007, though the quality of this data has been undermined by several months of observations being deemed "too unreliable to be published" between 2009 and 2012.
[2] DesRosiers Automotive Consultants Inc. and Statistics Canada